Weekly Credit Brief Nov 08 - Nov 14

A tale of two coals

by Crystopaz ANGGA

Donald Trump's victory is raising hope for coal mining's resurgence in America. As the President-elect vows to derail Obama's Clean Power Plan and revive the ailing coal industry, US coal companies could be one of the biggest beneficiaries of Mr. Trump's new energy policies. Trump's administration is expected to mark a new chapter for coal miners, who have been long battered by stringent environmental law and oversupply. The fortune, unfortunately, might not be shared equally amongst all coal miners. Considering the shale boom and cheap natural gas, thermal coal might not be able to defy the market forces that have led to coal's decline. Another type of coal, however, might still burn hot. Metallurgical coal, which is used in steelmaking, is likely to benefit more from the reduced environmental standards and the massive infrastructure spending under the President-elect Trump.

After waves of US coal bankruptcies in 2015-2016, the median RMI-CRI 1-year Probability of Default (PD) for 15 North American coal companies has fallen over the past 5 months (see Figure 1), indicating an improving operating condition in the US coal mining sector. The decline in PDs coincides with higher global metallurgical and thermal coal prices, which have risen by more than 300% and 100% respectively since the start of the year. The price rally was mainly driven by China's decision to restrict domestic coal production amid a supply glut, by reducing working days at coal mines to 276 days from 330 days.

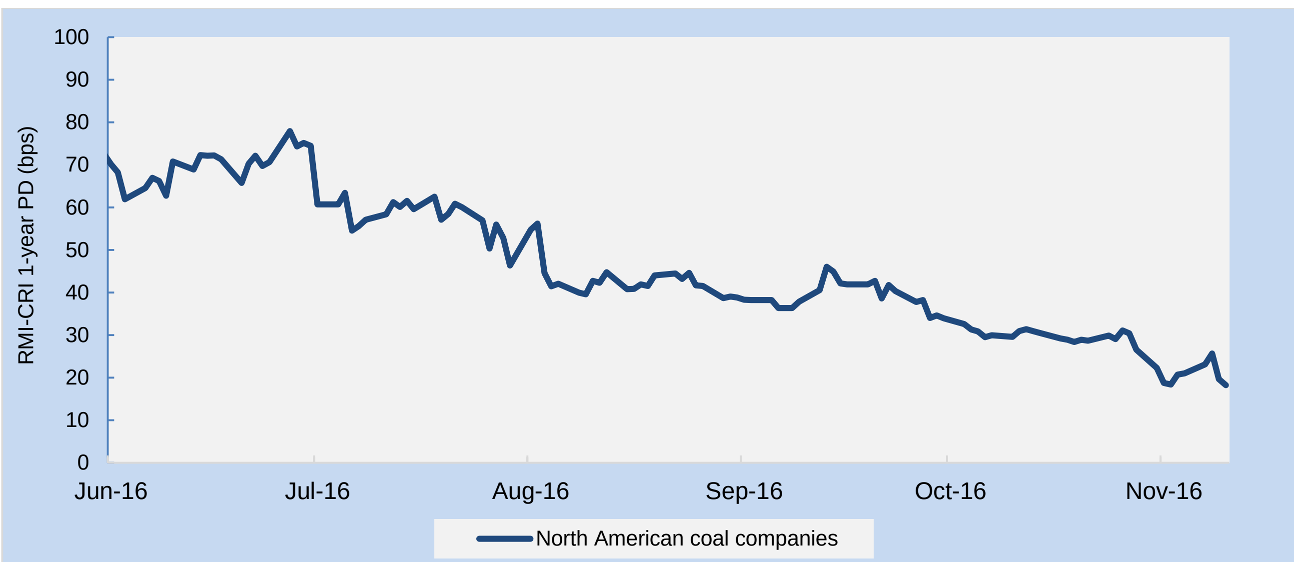

Figure 1: Median RMI-CRI 1-year PD for 15 North American coal companies. *Source: RMI-CRI*

In line with improvements in the global market, coal mining's operating condition in the US has recovered in the third quarter. Coal production in the US climbed to 217mn tons in Q3 2016, up from 165mn tons in Q1 and 151mn tons in Q2. Utility coal stockpiles have also decreased, albeit at a slower pace, from 194mn tons in Q1 to 162mn tons in Q3. Amid increased output and higher coal price, US coal miners reported higher earnings in the third quarter. Total EBITDA of the 6 largest public US coal companies rebounded from USD 260.4mn in Q1 2016 to USD 726.9mn in Q3 2016. Higher natural gas price in 2017 will also provide some relief for US coal miners. As natural gas price is expected to climb in 2017, US coal production is forecast to rise by 7% next year.

The outlook for thermal coal, however, remains challenging. Coal made up more than 80% of retired energy capacity in 2015, and coal's share of US power generation has dropped to a third in 2016 from half in 2008 while coal production has fallen from 1.17bn ton in 2008 to 897mn ton in 2015. Mr. Trump's promise to undermine Obama's Clean Power Plan will be instrumental in keeping the coal industry afloat. According to a study done by the US Energy Information Administration (EIA), the proposed Clean Power Plan would accelerate coal plant retirements and renewable energy additions. Under the Clean Power Plan scenario, 90 gigawatts of coal-fired plants are expected to retire by 2040, more than twice the figure predicted under the reference scenario (see Figure 2). However, with climate-change skeptic Myron Ebell helming the Environmental Protection Agency's transition team, regulations that require states to curb their carbon emission are likely to be scrapped to coal miners' relief.

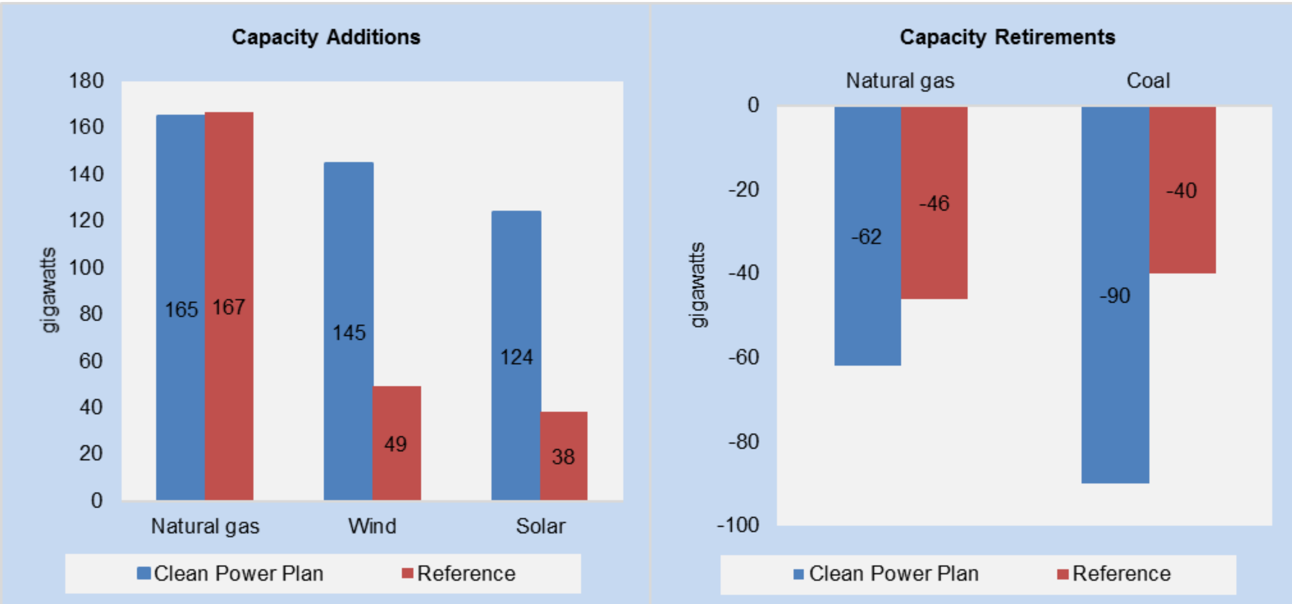

Figure 2: Projected US electric capacity additions and retirements in two cases, 2014-2040; the reference case is based on federal, state, and local laws in October 2014, prior to the enactment of Clean Power Plan. *Source: US Energy Information Administration*

Metallurgical coal, on the other hand, is well-poised to be Trump's biggest beneficiary in the short term. Buoyed by China's reduced coal output and pick-up in its construction sector, metallurgical coal has become one of the best performing commodities in 2016. Following the government restriction on domestic output, China's coking coal imports surged by 56% YoY in August while imports in the January-September period have risen by 20% YoY. As China's construction sector is forecast to grow by 7% in the next two years on the backbone of fiscal stimulus, the gains in metallurgical coal price are likely to be sustained. While the tightness in the metallurgical coal market can be reversed by China's decision to increase domestic coal supply, Trump's pledge to spend more than USD 500bn on infrastructure projects might galvanize hope for metallurgical coal miners in America.

In response to the market upturn, North American metallurgical coal companies have been quick to deleverage. In October 2016, Arch Coal, one of the biggest US coal miners, emerged from Chapter 11 bankruptcy with nearly USD 5bn debt removed from its balance sheet. CEO John Eaves is hopeful about metallurgical coal's resurgence in aiding the company's turnaround efforts. Similarly, Teck Resources, Canada's biggest diversified miner, also aims to reduce its debt below USD 5bn as it reported stronger profits on skyrocketing metallurgical coal prices. In 2016, the company managed to reduce its debt to USD 6.1bn from USD 7.2bn a year ago. The RMI-CRI 1-year Probability of Default (PD) for Teck Resources has also improved from 50bps in May to 8.7bps in November.

Building his campaign on coal miners' frustration, President-elect Trump offers a new hope for the beleaguered US coal companies. While Mr. Trump might not be able to reverse coal's increasing obsolescence, his attempts to undo Obama's clean energy legacy might delay more retirements of coal-powered power plants. Metallurgical coal, on the other hand, is likely to perform better due to tight global supply, pick-up in China's construction sector, and Trump's promised infrastructure development.

Credit News

China's economy holds ground as housing curbs start to bite

Nov 14. Amid curbs in major cities, property development investment rose 6.6% YoY for the first 10 months, up from 5.8% YoY for the first nine months. Even though cooling prices and fewer transactions will hurt services, construction fueled by investment remains key to driving output. Growth of private investment stabilized to 2.9% YoY in the first 10 months of 2016. An economist at Nomura Holdings said the cooling property sales in tier-1 cities will transmit to lower-tier cities and eventually drag property investment growth. Data also showed moderate credit and loan growth, while money supply increased slightly. An economist from Capital Economics in Singapore indicated that the slowing of credit growth and property market will hamper China's recent recovery in economic activity. (Bloomberg)

Italy's Monte Paschi enters crucial weeks for securing rescue

Nov 14. Monte dei Pashi di Siena (MPS) had lost EUR 14bn of its deposits since January 2016. The viability of MPS is threatened by market instability and leakage of deposits. The board is set to approve terms of a swap for its EUR 5bn subordinated debt into the equity with a current market value of just EUR 740mn. A cash premium to the market price of securities will be offered to subordinate bondholders should they use the proceeds to invest in the bank, accounting for EUR 1.5bn of the EUR 5bn capital shortfall for MPS. MPS also aimed to persuade Qatar and private equity funds to stump up about EUR 1.5bn. The remaining EUR 2bn will come from a rights issue that will take place immediately after the referendum that threatens to unseat reformist prime minister Matteo Renzi. (FT)

Canadian consumers pile on more debt in third quarter

Nov 10. According to credit report provider TransUnion, Canadians took on more debt in the third quarter, with delinquency rates on the rise. The report by TransUnion showed non-mortgage debt balances averaging at CAD 21,686 in the quarter, a 2.3% increase from a year earlier. Debt levels were also forecasted to rise to CAD 217,747 by the end of next year, potentially reaching CAD 22,000 by the end of 2018. TransUnion's director of research and analysis in Canada said that the Canadian government's recent downgrade of its economic outlook may have prompted consumers to borrow more, based on the belief that interest rates will remain low for an extended period. (Reuters)

Helicopter operator Erickson files for bankruptcy

Nov 9. Portland-based helicopter operator Erickson Inc. has placed its flying fleet into bankruptcy, citing reductions in drilling operation by oil and gas companies for the alleged bankruptcy. According to lawyers who placed the company into bankruptcy, profitability has been plummeting since 2013 and that the company would be unable to tide over the gloom in the distressed oil-and-gas industry where it provides lift services for production rig equipment. Erickson officials said they plan to open discussion with lenders involved in roughly USD 561mn of the company's debt. (WSJ)

Leading US subprime lender's shares plunge nearly 40%

Nov 9. America's biggest subprime lender OneMain Holdings' shares plummeted by almost 40%. OneMain Holding's shares plunge came on the back of the company's release of statement, stating that it was reining back on growth amid a spike in delinquencies. According to chief executive Jay Levine, the earnings per share of 19 cents was a long way from analysts' estimates of 41 cents, citing rising competition and a "challenging" integration of the branch networks of Springlead and OneMain for the disappointment in earnings estimates. (FT)

Freeport-McMoRan chief vows to complete debt reduction plan (FT)

Noble Group reports loss as debt pile shrinks USD 503mn (Bloomberg)

Petrobras posts big loss on write-downs (WSJ)

Regulatory Updates

Asset managers face corporate governance crackdown

Nov 14. The UK regulator has put a spotlight on the corporate governance of asset managers, leaving them facing a crackdown as pressure mounts on how asset managers vote on pay and monitor issues such as board independence and corporate strategy. The Financial Reporting Council has created three tiers, in terms of the quality of reporting, for its nearly 300 signatories to the stewardship code, which includes assets managers, pension funds and consulting groups. Groups that have not achieved at least Tier 2 status after six months will be removed from the list of signatories. (FT)

RBI overhauls debt restructuring schemes

Nov 11. The Reserve Bank of India has eased rules in existing debt restructuring schemes such as the S4A (sustainable structuring of stressed asset), 5/25 (loan refinance and extension) and SDR (strategic debt restructuring). According to the central bank, the regulation changes were needed to harmonize rules across various debt recast schemes. Bankers have welcomed the new requirements, as they provide lenders more flexibility in resolving bad loans that may lead to lower provisions and stronger credit profiles. (Business Standard)

Third of businesses do not meet corporate governance requirements (FT)

China central bank to keep liquidity ample, curb asset bubbles (Reuters)

China steps in again to restrain its commodity traders (Bloomberg)

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